

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
FRED W. HUTCHINSON )

Appearances:

For Appellant: Dale I. Stoops, Attorney at Law

For Respondent: F. Edward Caine, Senior Counsel;  
Israel Rogers, Assistant Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Fred W. Hutchinson to proposed assessments of additional personal income tax in the amounts of \$15,335.22, \$41,801.54, \$39,458.68, \$51,729.04 and \$52,291.95 for the years 1951, 1952, 1953, 1954, and 1955, respectively,

Appellant was engaged in the coin machine business in Solano and Napa Counties. He owned multiple-odd bingo pinball machines, horse race (also called one-ball) pinball machines, music machines, shuffleboards, and miscellaneous amusement machines. The equipment was placed in about 100 locations such as bars and restaurants. The proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between appellant and the location owner,

The gross income reported in appellant's returns was the total of amounts retained from locations. Deductions were taken for depreciation, salaries, cost of phonograph records and other business expenses,

Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to section 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code which reads:

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In computing taxable income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

The evidence indicates that the operating arrangements between appellant and each location owner were the same as those considered by us in Appeal of Wall, Cal., St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, 3 P-M State & Local Tax Serv. Sal. Par. 58145. Our conclusion in Mall that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is accordingly applicable here,

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962, 3 CCH Cal. Tax Cas. Par. \_\_\_\_\_, 2 P-H State & Local Tax Serv. Cal. Par. 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance,

It was the general practice to pay cash to players of appellant's pinball machines for free games not played off. Accordingly, the pinball machine phase of appellant's business was illegal, both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying section 17297,

Most of the locations had both pinball machines and music machines. The collectors collected from all types of machines and the repairmen serviced all types of machines. There was therefore a substantial connection between the illegal operation of pinball machines and the legal operation of music machines and miscellaneous amusement machines and respondent was correct in disallowing all the expenses of the business,

There were no records of amounts paid to winning players on pinball machines, and respondent estimated these unrecorded amounts as equal to 50 percent of the total amounts deposited in the pinball machines. Respondent did not disclose the basis for its 50 percent estimate. The location owners who were witnesses at the hearing were unable to give any estimate of the amounts paid to winning players on pinball machines. Appellant and three of his collectors who were witnesses estimated that the amounts paid to winning players on pinball machines averaged

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about one-third of the proceeds of the machines, Under the circumstances, we conclude that the unrecorded amounts paid to winning players on pinball machines equalled 33-1/3 percent of the total amounts deposited in the machines,

**O R D E R**

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Fred W. Hutchinson to proposed assessments of additional personal income tax in the amounts of \$15,335.22, \$41,801.54, \$39,458.68, \$51,729.04 and \$52,291.95 for the years 1951, 1952, 1953, 1954 and 1955, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Pasadena, California, this 27th day of November,  
1962, by the State Board of Equalization,

George R. Reilly, Chairman  
Richard Nevins, Member  
Paul R. Leake, Member  
John W. Lynch, Member  
                    , Member

ATTEST: Dixwell L. Pierce, Secretary